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Nos. 8 and 23

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 8

CHICAGO AND NORTH WESTERN RAILWAY COMPANY, ET AL.,
Appellants,

v.

THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, ET AL,
Appellees.

No. 23

THE UNITED STATES OF AMERICA AND INTERSTATE COMMERCE COMMISSION,
Appellants,

v.

THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, ET AL.,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF FOR APPELLEES ARIZONA CORPORATION COMMISSION, ET AL.

QUESTIONS PRESENTED

1. Whether appellants may properly defend the Commission's orders largely without reference to the revenue needs conclusions upon which they were based, where the principal issue throughout the proceedings, both before the Commission and in the District Court,

has been the sufficiency and the lawfulness of the findings underlying these revenue needs conclusions?

2. Whether the Commission's revenue needs findings are sufficient, where it has found neither the amount of the revenue needs of the groups of carriers involved nor the effect of its orders?

3. Whether the Commission's revenue needs findings are lawful, where these findings are based upon a passenger deficit theory which presumes that the Mountain-Pacific railroads can supplement their revenues by a reduction in their passenger deficits, even though there is no evidence of record to support that view, even though such a theory constitutes an unexplained departure from the Commission's own previous policies, and even though no hearing has been held on this factual question?

Whether, in addition to the errors committed affecting its treatment of the revenue needs of the various groups of railroads, the Commission committed further error in refusing to consider the impact of its orders upon the Denver & Rio Grande Western Railroad, where it is undisputed that the orders would have virtually destroyed that railroad, and where the railroad in question is an important part of the Nation's transportation system?

STATEMENT

These cases present consolidated appeals from a judgment of the United States District Court for the Southern District of California dated February 18, 1965. The judgment set aside certain orders of the Interstate Commerce Commission in its Docket No. 31503.

The appellants in No. 8 are the Chicago and North Western Railway Company and certain other railroads, hereinafter collectively referred to as the Midwestern railroads. The appellants in No. 23 are the Interstate Commerce Commission and the United States, hereinafter collectively referred to as the Government. The appellees are The Atchison, Topeka and Santa Fe Railway and certain other railroads, hereinafter collectively referred to as the Mountain-Pacific railroads; two Midwestern railroads, the St. Louis-San Francisco Railway and the Missouri-Kansas-Texas Railroad; the regulatory commissions of the States of Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah and Washington, on whose behalf this brief is being submitted; and the State of California, which is filing a separate brief.

A related controversy between the Eastern railroads and the appellees, as to which the Court also noted jurisdiction (No. 143, October Term 1965), has since been settled and the appeal dismissed. However, the remaining controversy involves the validity of both of the orders of the Commission in Docket No. 31503, dated March 21, 1963 AR. 1050) (as amended June 20, 1963) (R. 1053), and December 31, 1963 (R. 1108).

The factual background of these cases is fully developed in other briefs being filed in this Court. Accordingly, for the convenience of the Court, we shall not separately state the facts, but, instead, shall limit our brief to the facts necessary to develop specific arguments.

SUMMARY OF ARGUMENT

The briefs filed by the appellants herein substantially misstate the issues before this Court. In one

respect, they go far beyond the issues properly to be decided by the Court when the Government asks the Court to decide issues as to the lawfulness of the Commission's determination of relative cost of service, which were expressly reserved by the district court. For the most part ,however, the approach taken by the appellants is much too narrow in that they seek to brush aside, or at least drastically to minimize the importance of, virtually every one of the revenue needs issues upon which this case was tried and decided, both by the Commission and by the District Court.

The basic position of the appellants before this Court is that the revenue needs issues are largely unimportant because the increases prescribed by the Commission in the Midwestern railroads' divisions were based solely upon its findings with respect to relative cost of service. However, this position cannot be supported on the basis of what the Commission actually said in its reports, for these divisions were expressly designed to reflect what the Commission called "the broader aspects of revenue need." And appellants' position in this Court is flatly inconsistent with arguments which they made to the District Court that their new divisions should be upheld on the basis of the Commission's findings on revenue needs. The evidence of record before the Commisison made it plain that the Commission should consider the broader aspects of revenue need in prescribing these divisions, and the Commission attempted to do so. The errors of the Commission in treating the matter of relative revenue needs were therefore critical to its decision, and those errors are critical on these appeals.

A plain error committed by the Commission arose

from its failure actually to determine either the revenue needs of the carriers or the effect of divisions prescribed supposedly to reflect revenue needs. The Commission took the position that it need not make such findings in a divisions case because the prescription of divisions is a matter wholly within its discretion. But this position is flatly contrary to Section 8(b) of the Administrative Procedure Act (5 U.S.C. § 557(c)), which requires that the Commission make reasoned findings on all material issues. In *Chicago, Milwaukee, St. P. & P. R. Co.* v. *Illinois*, 355 US 300, 309-310 (1958), the Court applied this findings requirement in a situation virtually indistinguishable from that presented here, holding that a Commission order based upon the revenue needs of a railroad must be accompanied by a finding as to what those needs are, as well as a finding as to the revenue effect of the order.

Appellants' contention that the *Milwaukee Road* principle was satisfied here by the Commission's statement that the divisions prescribed for the Midwestern railroads were designed to produce "moderate increases" plainly is not sound. In the first place, there was no evidence in the record from which the Commission could properly have measured the effect of the divisions it prescribed, even in general terms. Appellants' efforts to bring in evidence from outside the record to cure this defect must be unavailing, for it is well settled that an administrative order must be upheld, if at all, on the grounds relied upon by the administrative agency. *Securities & Exchange Commission* v. *Chenery Corp.*,

332 U.S. 194, 196-197 (1947). In any event, the term "moderate" is much too vague in this context to satisfy the requirement of reasoned findings upon which the *Milwaukee Road* principle is based. Indeed, as sought to be applied here, that term is virtually meaningless, for some of the divisions of the Midwestern railroads were increased by more than 100 percent. If a wholly unsupported characterization of changes in divisions of this range and magnitude as "moderate" is held to satisfy the *Milwaukee Road* principle, that principle itself has become virtually meaningless.

The Commission also erred in reaching even its general conclusions on the issue of relative revenue needs. The basic revenue needs issue before the Commission revolved about the fact that the Mountain-Pacific railroads have a much greater need for revenue than the Midwestern or Eastern railroads because the growth of the West has generated a necessity for substantial extensions of, and improvements in, the existing rail system. The Commission acknowledged the existence of this greater need for investment funds in Mountain-Pacific territory, but it refused to recognize this need in the divisions it prescribed because, in its view, the Mountain-Pacific railroads' passenger deficits were excessive. The Commission took the position that the revenue needs of the Mountain-Pacific railroads should be met by a reduction in their passenger deficits, presumably through a discontinuance of substantial amounts of passenger service. This disposition of the

basic revenue needs issue in this case was unlawful on at least three grounds.

First, the Commission's passenger deficit theory is unlawful because it proceeds from the premise that a reduction in the Mountain-Pacific railroads' passenger service would automatically improve the financial condition of those railroads. This is not so. The passenger deficits of a railroad reflect, not only the direct costs of providing passenger service, which could be saved by discontinuing that service, but, also, a proportion of the joint and overhead costs of the railroad, which would have to be borne even if no passenger trains were operated. Thus, a discontinuance of the passenger service of a railroad might result only in the shifting of joint costs from passenger to freight service, without any improvement, and possibly with some substantial deterioration, in the railroad's financial condition. That is precisely what is involved here. When the passenger deficit theory was first injected into this case, the Mountain-Pacific railroads offered to prove that their passenger service actually produces revenues $26 million a year in excess of the costs that could be avoided by discontinuing the service under the Commission's own standards, and no one has challenged the authenticity of this claim. Thus, the savings which the Commission visualizes from a discontinuance of passenger service simply do not exist, and its disposition of the basic revenue needs issue on the theory that such savings do exist is plainly arbitrary and unsupported by substantial evidence.

The Commission's reliance upon its passenger deficit theory is also unlawful because it ignores the established principle that a railroad is an integrated utility providing both passenger and freight service, the results of which must be judged together. This principle has been applied both by the Commission and by the courts in numerous train discontinuance cases and in various kinds of rate cases. The same principle is embodied in Section 15(6), for that section directs the Commission's attention to all "railway property held for and used in the service of transportation." This Court's decision in *Baltimore & Ohio R. Co* v. *United States*, 298 U.S. 349, 360 (1936), would seem to indicate that, insofar as overall revenue needs are concerned, Section 15(6) *requires* the Commission to consider freight and passenger service together. But whether the statute actually places such a flat requirement on the Commission or not, the Commission's action here cannot stand. For whatever the Commission's power, it has a duty under Section 8(b) of the Administrative Procedure Act to explain its decisions and support them with reasoned findings, and that duty plainly has not been fulfilled. Since the Commissions's action constitutes a radical departure from previously established policies, the need for reasoned findings was all the more important. *Secretary of Agriculture v. United States*, 347 U.S. 645, 652-653 (1954). But the Commission adopted its passenger deficit theory here without any explanation of the basis of that theory or the reason why it chose to abandon its previous policies.

Finally, the Commission's passenger deficit theory is unlawful because the parties were denied their right to a fair hearing with respect to the factual issues raised by such a theory. The passenger deficit theory was not suggested by any party to the proceeding, nor did the Commission's examiners, or any other member of its staff, give the parties notice that the Commission might rely upon such a theory to resolve the basic revenue needs issue before it. At the earliest possible opportunity following the injection of the theory into the case in the examiners' Recommended Report, both the Mountain-Pacific railroads and these state regulatory commissions objected to the Commission's reliance upon the theory and offered to prove that the factual assumptions underlying it were not true. But the Commission adhered to the passenger deficit theory without a further hearing. This was error, and particularly so in view of the harsh consequences to the public interest which flow from a theory which urges the railroads to discontinue passenger service without regard to the need for such service. We do not think such a theory should ever be adopted, but if it should, plainly there should first be a hearing at which the issue is considered and all interested parties are given a chance to be heard.

The District Court also held the Commission's treatment of the revenue needs issue in this case to be deficient because the Commission refused to consider the effect of its orders upon the revenue needs of individual railroads. Although appellants seek to make it appear that this holding involves broad questions of the Com-

mission's power to prescribe divisions on a group basis and that the District Court's holding has made Section 15(6) literally unworkable by imposing upon the Commission a duty of making separate findings for 300 railroads, the fact of the matter is that only one Mountain-Pacific railroad has ever requested that separate findings be made with respect to its individual situation, and the District Court's holding extends no further than that one railroad insofar as the need for *separate* findings is concerned.

The Commission's orders would have a disproportionate impact upon the Denver & Rio Grande Western Railroad; the total effect of the orders would deprive that railroad of $8-½ million a year in revenues and put it on the brink of bankruptcy. But when the Rio Grande sought to show these facts to the Commission, it refused to give any consideration at all to the Rio Grande's situation on the theory that it had waived its right to individual consideration.

Appellants' broad argument about the Commission's power to prescribe divisions on a group basis merely obfuscates the plain duty of the Commission to consider what it is doing to a railroad like the Rio Grande before it virtually destroys that railroad. The Rio Grande is an important part of the Nation's transportation system, particularly to the states of Utah and Colorado, which it directly serves. The suggestion that such a railroad can simply be destroyed in a divisions case because it is too much trouble for the Commission to consider its individual situation is unthinkable.

Nor do we think that such a result could justifiably be reached on any ground of waiver. The District Court held that there had been no waiver of the Rio Grande's rights, and we agree with this. But even if the Rio Grande did waive its rights, it plainly did not—for it could not—waive the rights of the public which depends upon it for rail transportation. The Commission itself has the primary responsibility for protecting the public in situations of this kind, and here that responsibility certainly required that it consider what it was doing to the Rio Grande.

ARGUMENT

I. APPELLANTS MISSTATE THE CRITICAL ISSUES BEFORE THIS COURT.

Appellants' briefs do not fully and precisely describe the issues before this Court. On the one hand, we think that the Government's brief is much too broad in seeking to inject the Court into matters not properly at issue here, while, on the other hand, we think that both briefs are much too narrow in failing adequately to deal with critical aspects of the issues which are here. We shall therefore undertake briefly to define the issues before the Court, as we see them, before discussing the legal principles upon which we think this case should be decided.

The Interstate Commerce Commission declared the existing divisions of joint rates on transcontinental freight traffic unlawful and prescribed new divisions effective July 1, 1963. The Commission prescribed a

series of new divisional percents for the Eastern railroads, the purpose of the new percents being substantially to increase the divisions of joint revenues accruing to the Eastern railroads (R.1035). For the Midwestern railroads, the Commission prescribed scales of prorating factors consisting of certain allowances for terminal and line-haul services, the asserted purpose of the new scales being to "produce moderate increases in some of the most important midwestern divisions" (R. 1039).

The stated reason for the Commission's action was certain conclusions reached regarding relative costs and relative revenue needs (R. 1032):

> "From our consideration of the cost evidence previously discussed in this report, we are convinced that the present divisions are favorable to the defendants to an extent not justified by ascertainable cost differences. The evidence, however, does not provide an acceptable pattern for readjusting the existing divisions, which must reflect certain broader aspects of revenue need."

Hence, in the District Court, appellees attacked the Commission's decision on both cost and revenue needs grounds. They contended that the Commission had made independent errors in reaching its conclusions on each of these subjects, which vitiated its entire decision and required that its orders be set aside.

The District Court however, based its decision setting aside the Commission's order wholly upon the issues raised with respect to the matter of relative revenue needs. Because it found the Commission's treatment of this subject legally deficient in several respects, the

Court found it "unnecessary to discuss issues 20 to 30" dealing with relative cost of service (R. 1733).

In this posture of the case, the only issue before this Court is the correctness of the District Court's conclusion that the Commission committed legal error in its treatment of relative revenue needs. *United States v. Great Northern R. Co.*, 343 U.S. 562, 577-578 (1952); *Seaboard Air Line R. Co. v. United States*, 382 U.S. 154 (1965).

In this respect, the position taken by the Government in its brief (Government Brief, pp. 61-62) is much too broad. It suggests that this Court should consider all of the findings made by the Commission and determine whether the Commission's ultimate orders constitute a rational exercise of discretion. Quite plainly, the Court should do no such thing. It should determine only whether the District Court's holding is correct. If the District Court is correct, the case should be affirmed; otherwise, it should be remanded to the District Court for consideration of the issues which that court has not yet reached.[1]

When the appellants address themselves to the issues which are before the Court, on the other hand, their approach is much too narrow. Thus, appellants assert that the divisions prescribed can be justified on the basis of the Commission's findings on cost of service (Midwestern Brief, pp. 45-50; Government Brief, pp. 11-12).

[1] The Midwestern railroads concede that appellees are entitled to invoke the practice of this Court of not deciding issues not reached by the court below (Midwestern Brief, p. 50, note 39). Accordingly, they do not ask the Court to uphold the Commission's orders, but only that the judgment of the District Court be reversed (Midwestern Brief, p. 112).

On this basis, they seek to minimize the importance of the revenue needs issues.

The Government directs virtually all of its attack to the District Court's holding that before divisions may be prescribed on the basis of revenue needs, findings must be made to justify such action as to any individual railroad which insists upon consideration of its situation (Government Brief, pp. 26-45).

The Midwestern railroads go somewhat further than this and discuss the further holdings of the District Court that in the the circumstances of this case, the revenue needs findings should have been made "in terms of dollars" (R. 1724) (Midwestern Brief, pp. 66-78), and that the revenue needs of the Mountain-Pacific railroads should not have been discounted because of their high passenger deficits (Midwestern Brief, pp. 61-66). However, these aspects of the Midwestern railroads' brief hardly broaden the treatment of the revenue needs issues beyond the individual railroad problem for the discussion of these other issues is not put in the context in which the revenue needs issues actually arose, and the discussion is largely limited to an abstract treatment of various types of financial evidence. By virtue of this approach, the appellants either completely ignore or effectively submerge most of the important revenue needs issues in this case.

These efforts to minimize the importance of the revenue needs issues in this case and to brush those issues aside without full discussion are not sound. As is shown in the brief of the appellee Mountain-Pacific railroads, appellants' suggestion that the orders of the Commis-

sion involved here are based upon cost determinations cannot be supported by the Commission's report, and is directly contrary to the position taken by these very appellants before the District Court. The Commission's orders were expressly based upon the "broader aspects of revenue need" (R. 1032), so the orders must be upheld, if at all, on the ground that the Commission rationally articulated a connection between that basis and the ultimate orders which it issued. *Burlington Truck Lines v. United States,* 371 U.S. 156, 167-169 (1962). This fact alone makes the revenue needs issues in this case critical.

Furthermore, the Commission was obligated under the circumstances here to go beyond mere cost estimates and take into account the overall revenue needs of the railroads. The nine states on whose behalf this brief is being submitted have a vital stake in the final outcome of this massive dispute over the division of revenue among most of the nation's railroads—a stake which extends far beyond a mere determination of the cost of service incurred by those railroads in producing the revenues.

The people of our states rely upon the Mountain-Pacific railroads to provide adequate and reliable railroad transportation service at rates which will permit the variety of commodities produced in these states to be profitably marketed throughout the United States. Our producers must compete in eastern markets with producers more favorably located to those markets geographically. Our railroads must, therefore, be able to provide prompt and reliable service and suitable equip-

ment for the longest and most difficult hauls encountered anywhere in the country.

The present rail system available to the Mountain-Pacific states is not nearly adequate to meet our needs (R. 446, 456). Many areas have no rail service at all, and even where service exists, shortages of vital equipment such as freight cars are the rule rather than the exception (R. 444, 450).

The problem is most acute in newly developing areas where rail service previously was either not needed at all or was useful to a much lesser extent. The economic growth of these areas is, in many instances, completely dependent upon an extension of, or substantial improvement in, existing rail services. If the railroads are to provide essential transportation service for the Mountain-Pacific states, they must therefore continuously make substantial new investments in their plant and equipment (R. 447). And these new investments are critical to the flow of the very transcontintal traffic involved here, for much of the traffic moving via new extensions or in new freight cars must move to and from the principal markets outside Mountain-Pacific territory.

The situation is quite different in the Midwest. The Midwestern railroads are not faced with such a rapid growth. Indeed, they have an overabundance of railroad plant, not a shortage. With respect to the bulk of transcontinental traffic, they have no need whatever for additions to existing facilities, for this traffic moves over a relatively small number of high density routes which have long since been completely established. The car

supply problem of the Midwestern railroads is also less acute. As bridge carriers on the large volume of transcontinental traffic moving to and from the East, these railroads do not have the responsibility for car supply.

For all these reasons, the Commission had a plain duty under Section 15(6) to consider the overall revenue needs of the Mountain-Pacific railroads to provide expanded rail service to the Mountain-Pacific states in determining the proper divisions of transcontinental freight revenues. Section 15(6) of the Interstate Commerce Act (49 U.S.C. § 15(6)) provides that in prescribing divisions between railroads, the Commission must consider not only the relative costs and the relative revenue needs of the railroads involved, but also, "the importance to the public of the transportation services of such carriers."

It has been plain from the outset of this case that the efforts of the Eastern and Midwestern railroads to divert substantial revenues from the Mountain-Pacific railroads places in jeopardy the continued industrial growth of the Mountain-Pacific states (R. 447). The record shows that the Mountain-Pacific railroads depend upon their divisions of transcontinental freight revenues for nearly one-half of their total gross revenues (R. 146, 995). Consequently, any substantial loss of revenues through reduction in the transcontinental divisions of those railroads would have a profound effect upon their entire financial structure, and upon their ability to provide adequate service in the future to the shipping public of these states.

Thus, the burden of any revenue losses imposed upon the Mountain-Pacific railroads in this case would, in all

probability, ultimately be borne by the shipping public of the Mountain-Pacific states through increased freight rates or reduced railroad service or both. This in turn would be felt by the general public through a slowing in economic growth. This would be especially true in those industries such as lumber, mining and agriculture, which depend most upon eastern and midwestern markets for the sale of their products. In this situation, the explicit mandate of Section 15(6) required the Commission to consider the public interest in, and need for extension and improvement of, rail service in Mountain-Pacific territory and to determine whether any divisions which it prescribed would hamper the ability of the Mountain-Pacific railroads to provide such service.

Hence, the question of the lawfulness of the Commission's treatment of the revenue needs of the railroads is the most important question before this Court. And that question turns upon the same revenue needs issues which were presented to the District Court, as stated in the stipulated List of Issues Remaining in Controversy submitted to the District Court (R. 1325-1345):

> (1) Whether, however revenue needs are properly to be measured, the Commission acted unlawfully in prescribing increases in the Midwestern railroads' divisions to meet such revenue needs, without finding either the extent of those railroads' needs or the impact of the prescribed divisions (R. 1326-1328);
>
> (2) Whether the Commission's holding that differences in requirements for investment funds could be disregarded because of the high passenger deficits the Mountain-Pacific railroads constitutes a lawful

disposition of that issue, or whether these passenger deficit findings constitute a further violation of law which requires that the Commission's orders be set aside (R. 1334-1338); and,

(3) Whether, however revenue needs are measured, and regardless of the specificity of the findings that are required on that subject, the Commission acted unlawfully in failing to consider the revenue needs of those individual railroads which objected to the group divisions prescribed as unfair to them (R. 1329-1330).

As we read the District Court's opinion, it upholds the appellee's position on each of the above issues. Consequently, in reviewing the District Court's decision, this Court should consider and pass upon each of these issues. For the reasons which will be discussed in detail below, the District Court's judgment setting aside the Commission's orders can and should be upheld.

II. THE COMMISSION ERRED IN FAILING TO FIND EITHER THE REVENUE NEEDS OF THE RAILROADS INVOLVED OR THE EFFECT OF ITS ORDERS UPON THE CONTENDING RAILROAD GROUPS.

Perhaps the clearest error in the reports and orders involved in this case arises from the Commission's failure to find either the revenue needs of, or the effects of its orders upon, the contending railroad groups here. As pointed out above (pp. 12, 15 *supra*), the Commission relied substantially on the supposedly greater revenue needs of the Midwestern lines in justification of the prescribed divisions. Yet it made no findings and reached no conclusions as to how the prescribed divisions would improve the financial condition of the Midwestern

railroads. Nor did it find how those divisions would affect the financial condition of the Mountain-Pacific railroads. The Commission failed to set forth how much greater the revenue needs of the Midwestern railroads are than those of the Mountain-Pacific lines. It failed to setforth how the transfer of revenue under the prescribed divisions would satisfy the revenue needs of the Midwestern railroads. There are no findings even in general terms as to what part of the allegedly greater needs of Midwestern railroads should be met out of transcontinental freight revenues.

The Commission took the position that the prescription of divisions is a matter within its discretion as to which such findings are unnecessary, regardless of the basis of its decision (R. 1067-1068):

> "There is no single yardstick or criterion which can be employed in determining fair divisions. *Baltimore & O. R. Co. v. United States,* 298 U.S. 349, 359. The question of what constitutes just and reasonable divisions involves the making of practical judgments and cannot be solved as though it were a mathematical problem. *Boston & Maine R.R. v. United States,* 208 F. Supp. 661, 675. In every divisions case it is customary to receive evidence relating to revenue need, the term which briefly covers 'the amount of revenue required to pay their respective operating expenses, taxes, and a fair return on their railway property held for and used in the service of transportation.'
>
> * * *
>
> "There is no rule, statutory or otherwise, requiring that, as a condition to the exercise of our authority in cases involving divisions, we must find in terms of dollar amount the difference between the revenue

> produced by lawful divisions as compared to the revenue produced by unlawful divisions. Nor is there authority to support the contention that such evidence as to revenue need can only be considered when it is possible to make the three findings suggested above."

This position is plainly unsound. Section 8(b) of the Administrative Procedure Act (5 U.S.C. § 557(c)) requires that all decisions of the Commission shall include a statement of "findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record." See *Burlington Truck Lines v. United States,* 371 U.S. 156, 167-168 (1962). In any case where the issue before the Commission is the amount of revenue which a carrier should get from one part of its business in order to insure a just contribution to its overall revenue needs, Section 8(b) makes a determination as to the amount of the overall needs and the amount of the transfer that should be made to meet those needs an absolute prerequisite to decision. This principle was plainly stated in *State of Illinois v. United States,* 146 F. Supp. 195 (ND. Ill. 1956), and this action was expressly upheld by this Court in *Chicago, Milwaukee, St. P. & P. R. Co. v. Illinois,* 366 U.S. 300, 309-310 (1958), where the Court said:

> "It is axiomatic that to know whether something is a fair proportionate part of something else, we must be told what the something else is."

The District Court adopted and relied upon this principle as flatly condemning the Commission's view that it need make no such findings (R. 1725), and, as we read

the appellants' briefs, they do not directly challenge that principle here. Instead, they claim that the principle was satisfied as to the Midwestern railroads, by the Commission's statement that it was prescribing "moderate increases" in the Midwestern divisions (Government Brief, pp. 51, 52; Midwestern Brief, pp. 67, 68, 69). Appellants urge that the Commission's use of the term "moderate increases" to describe the effect of its orders constitutes a sufficient finding as to amount to satisfy the *Milwaukee Road* principle, and they argue that the District Court's requirement that the Commission go further and find the dollar effect of its order "could serve no useful purpose and would be wholly formal and ceremonial in character" (Midwestern Brief, p. 78).

This position ignores the fact that there is no evidence in the record by which the Commission could have determined that the effect of its orders was "moderate." Appellants seek to cure that defect in this Court by supplying a figure from outside the record (Midwestern Brief, p. 73), but this is clearly improper. It is not for this Court to determine, in the first instance, what the divisions of the Midwestern railroads should be. *Securities & Exchange Commission v. Chenery Corp.*, 332 U.S. 194, 196 (1947). As is shown in the brief of the Mountain-Pacific railroads, the evidence actually before the Commission showed that many of the increases ordered in the Midwestern divisions were far from "moderate," ranging as high as 148 percent.

When the Commission's orders are judged in the light of their true effect as shown by the evidence of

record on that point, it is plain that the Commission's only statement that there should be "moderate increases" in the Midwestern railroads' division falls far short of satisfying the principle stated by this Court in the *Milwaukee Road* case. The meaning of the term "moderate" is obscure in any context. When it is applied to increases in divisions ranging over 100 percent, the term simply becomes meaningless. The *Milwaukee Road* requirement is satisfied only if the Commission finds the revenue needs of the railroads and the effect of its order on their revenues, for only then can the Commission determine whether one is a fair proportionate part of the other. Plainly, that has not been done here.

This is a matter of serious concern for these appellees, not only in this case, but, also, because of the general importance of the *Milwaukee Road* principle in protecting our interests. In recent years, the Interstate Commerce Commission has been given more and more authority to override the decisions of state regulatory agencies in such matters as train discontinuances and intrastate rates (see e.g., 49 U.S.C. § 13(a)(2), 49 U.S.C. § 13(4)). The principal protection left for the states in these areas is the requirement of Sections 8(b) and 10(e) of the Administrative Procedure Act (5 U.S.C. §§ 557(c), 706(2)(E)) that the Commission justify its decisions with reasoned findings based upon substantial evidence. Time and again these requirements have prevented the interests of the states from being overridden by the Commission without the slightest justification. See, e.g.,

North Carolina v. United States, 325 U.S. 507 (1945); *Public Service Commission v. United States,* 356 U.S. 421 (1958). But such protection of the interests of the states has been possible only because the Commission has been held to a meaningful standard of necessary findings. Without such a standard, both the findings requirement and the substantial evidence requirement would become virtually a dead letter, for there is always some sort of vague indication of what the Commission has done and some sort of evidence that might arguably support that general kind of action.

That is precisely the situation here. Appellants point to the Commission's statement that the Midwestern railroads are entitled to "moderate increases" and argue that this is supported by the evidence with respect to relative cost of service, even though admittedly there is no connection at all between the Commission's orders and the evidence relied upon (Midwestern Brief, pp. 94-95). Indeed, the Commission expressly found that the divisional scale prescribed for the Midwestern railroads was not based upon costs (R. 1078). In this situation, appellants' insistence that the Commission's action was nonetheless adequately and rationally explained simply confirms the notion that under the approach they urge, anything can be justified. We submit that the Commission should not emasculate the *Milwaukee Road* principle in any such manner. That principle should be applied here, and it clearly requires that the Commission's orders be set aside.

III. THE COMMISSION ACTED UNLAWFULLY IN IGNORING THE BASIC REVENUE NEEDS ISSUE PRESENTED TO IT ON THE UNLAWFUL GROUND THAT THE REVENUE PROBLEMS OF THE MOUNTAIN-PACIFIC RAILROADS STEM FROM THEIR PASSENGER DEFICITS.

The insufficiency under the *Milwaukee Road* principle of the Commission's statement that the Midwestern railroads are entitled to "moderate increases" in their divisions requires that the Commission's orders be set aside, regardless of the lawfulness of the findings underlying that vague conclusory assertion. However, the unlawfulness of the Commission's orders does not end there, for the Commission's conclusion on revenue needs is also basically defective in that the Commission relied upon an irrational and unlawful ground to resolve the basic issue between the parties as to the standard by which revenue needs are to be measured under Section 15(6). This led the Commission to apply an unlawful standard in its general determination of relative revenue needs, which constitutes an independent ground requiring that its action be set aside.

The basic revenue needs issue as it developed in these proceedings revolved about the need of the Mountain-Pacific railroads for necessary revenue to provide adequate rail service. The Mountain-Pacific railroads and these appellees introduced voluminous evidence before the Commission to establish the critical nature of this need (R. 140-145, 289, 457). The record also shows that the additional investment actually made in recent years to meet this need has been staggering. During the last

five years covered by the record, the Mountain-Pacific railroads increased their net investment in facilities by more than $800 million in an effort to keep pace with the growing demands for rail service in our territory (R. 292). This represented an investment of 70 percent of the net railway operating income of the Mountain-Pacific railroads (R. 293). In spite of this huge new investment, the record shows that the Mountain-Pacific states have suffered substantial and frequent critical equipment and service shortages (R. 442-447, 449-451). These shortages have caused numerous plant shut-downs and loss of employment. The amount of economic loss has been staggering.

The demand for new railroad plant and equipment investment has been markedly less in the Midwest and the East than it has been in the Mountain-Pacific states. This fact is also documented in the record by uncontroverted evidence showing comparative increases in net investment for each of the three groups of railroads during the same five year-period (R. 292):

Growth in Net Investment
In Transportation Property
(millions)

	East	Midwest	Mountain-Pacific
January 1, 1951	$10,771	$ 4,851	$ 4,760
December 31, 1955	11,425	5,301	6,561
Increase	$ 654	$ 450	$ 801
Percent Increase	6%	9%	14%

The basic issue before the Commission throughout these proceedings has been to assess the significance of

these investment needs of the Mountain-Pacific railroads and to determine the impact of these needs upon the overall revenue needs of the Mountain-Pacific railroads as compared to the overall revenue needs of the other railroads involved in this case. Quite plainly, this issue could not be resolved merely by reference to a comparison of the net income positions of the various groups of railroads. For although the Mountain-Pacific railroads had slightly higher net income on the average than the Midwestern railroads or the Eastern railroads, their greater investment requirements more than offset these income differences and left the Mountain-Pacific railroads with substantially less income for distribution to shareholders than either of the other two groups of railroads (R. 143). On this basis, we contended before the Commission that the revenue needs of the Mountain-Pacific roalroads were greater than those of the other two groups of railroads, despite their slightly better net income position.

The Commission effectively ignored this contention, saying (R. 1033):

> "The railroads in all sections of the country are faced with the continuing necessity of raising funds for additions and betterments and new equipment, and we cannot recognize any difference in the degree of this urgency among the territorial groups."

Appellants seek to make it appear that this is a finding of fact that there is "no difference in the degree of revenue need among the groups of carriers" (Midwestern Brief, p. 59). This plainly is not so. Indeed, to the extent that this refusal to *recognize* differences in investment

needs is treated as a finding of fact that such differences do not exist, it is demonstrably contrary to evidence which is absolutely uncontroverted in this record. The record shows that a substantial shift in population and industry to Mountain-Pacific territory from the East and Midwest is in progress, and the Commission itself elsewhere so found (R. 1015). The need for additional investment to meet the demands imposed by this growth is axiomatic, as is the fact that such need is greater than it is in the East and Midwest where industry is contracting. The critical facts are reflected in the actual investments made by the various groups of railroads during the periods shown in the record, which the Commission treated as representative. These facts establish beyond question that the need for new railroad investment is greater in Mountain-Pacific territory than it is either in the Midwest or in the East.

Actually, the above-quoted portion of the Commission's report is not a finding of fact at all. It is merely a conclusion explaining why the Commission had brushed aside the revenue need question. The Commission refused to recognize the differences in amount of investment needs shown in the record, but it refused, not because of any belief that such differences do not exist, but because it concluded that even though these differences do exist, they need not be recognized. And the basis for this conclusion was the Commission's decision to discount the revenue needs of the Mountain-Pacific railroads because of their passenger deficits.

The relationship between the Commission's conclu-

sion on the basic revenue needs issue and its views with respect to the Mountain-Pacific railroads' passenger deficits is not a matter of conjecture, for it is expressly stated in the Commission's reports and is expressly recognized by the appellants here (R. 743-744). The passenger deficit theory upon which the Commission decided the basic revenue needs issue was injected into this case by the Commission's examiners. They regarded the Mountain-Pacific railroads' passenger deficits as excessively high and relied upon this belief to reject the revenue needs evidence presented both by those railroads and by these appellee state commissions. In doing so, the examiners also criticized the state commissions for not taking a "sympathetic attitude" toward passenger train discontinuances (R. 743-744):

> "It has already been pointed out in this report that the various changes in the country's freight-rate structure in the past 15 years have not prevented the mountain-Pacific railroads from attaining a greater degree of prosperity as freight carriers than the eastern and midwestern lines. The mountain-Pacific lines, however, are losing relatively much more money than the others on their passenger traffic, and we see no reason for offsetting those losses by increases in their revenue from transcontinental freight. The obvious answer to the question stated in the foregoing quotation is that a reduction in the passenger deficit of the mountain-Pacific lines, which would seem to be imperative sooner or later, should help materially in furnishing funds for additions and betterments. The interveners are in a position to assist in such a course by taking a sympathetic attitude toward discontinuance of unprofitable passenger service. The American railroads other than the defendants in 1959 had a total pas-

senger deficit 15 percent lower than they had in 1948. *If the defendants had been able to do as well, they would have had a saving of $67.8 million in 1959*" (emphasis supplied).

In its original report, the Commission also pointed to the Mountain-Pacific railroads' high passenger deficits as the whole cause of their revenue need problem and the key to its solution (R. 1026):

> "The comparisons of freight net railway operating income and passenger deficits also have a bearing on the assertion of the defendants that 'the increased investment required in serving the growing mountain-Pacific territory has produced no return owners of the mountain-Pacific roads.' This alleged deprivation results from passenger deficits of those roads, as will now be explained."

The Commission's report dropped the language criticizing the state commissions. It adopted, however, the examiners' passenger deficit theory in virtually the same language used by its examiners (Compare R. 736-744 with R. 1023-1029).

In its supplemental report the Commission reiterated its belief in the overriding importance of these data to the basic revenue needs issue (R. 1075):

> "We regard them [passenger deficits] as important in connection with the claimed revenue needs of the transcontinental defendants discussed in our original report."

The basic theory of the Commission, as expressly stated by the examiners and implicit in both of its reports, is that the overall revenue needs of the Mountain-Pacific railroads should not be considered because a sub-

stantial part of those needs result from excessively high passenger deficits which, to use the words of the Government, are "presumably not permanent in nature" (Government Brief, p. 16, note 10). Although appellants expressly concede that the Commission relied upon its views with respect to the Mountain-Pacific railroads' passenger deficits in dealing with the basic revenue needs issue (Government Brief, p. 16; Midwestern Brief, p. 64, note 56), they make no effort to support the theory underlying this action or to show how the District Court erred in remanding the case to the Commission for a determination based upon "the revenue needs of the carriers for *all* transportation services, including needs represented by passenger deficits" (R. 1733). We submit that the District Court was clearly correct in this action.

First, and perhaps most importantly, the Commission's decision to discount the overall revenue needs of the Mountain-Pacific railroads on the theory that a part of such needs could be met by a reduction in their passenger deficits is unlawful because it simply is not so. The only way suggested for a reduction in these deficits —namely, that these state regulatory commissions take a sympathetic attitude toward passenger train discontinuance applications—would not in fact improve the financial condition of the Mountain-Pacific railroads. Passenger deficit figures include a substantial amount of joint expense such as maintenance of track, roadbed, bridges and the like, over which both freight and passenger trains operate. General overhead items also are

apportioned among freight and passenger operations. Passenger deficits therefore are the product of a formula prescribed by the Commission which allocates expenses in relation to the amount of freight and passenger service provided. The more passenger service rendered, the more overhead and maintenance expenses are allocated thereto. Consequently, the more passenger trains a railroad operates, the higher its passenger deficit will be. Conversely, a reduction in passenger service will tend to shift more joint expenses to freight service and reduce a railroad's passenger deficit.[2]

There is not the slightest evidence in the record in this case to justify the presumption that a reduction in the passenger deficits of the Mountain-Pacific railroads would have any effect other than to shift the common costs now borne by passenger service on those railroads to freight service. Quite the contrary, the record indicates that this is precisely what would happen, for when

[2] A recent example which sharply illustrates this principle when appellee Western Pacific Railroad attempted to discontinue its last passenger train, the California Zephyr. The Commission ordered that the train be continued for another year notwithstanding an admitted out-of-pocket loss of $701,000 for the year 1965, I.C.C. Finance Docket 24277, *Western Pacific Discontinuance of Trains Nos. 17 and 18 Between San Francisco, Calif., and Salt Lake City, Utah* (decided February 13, 1967). However, because of the allocation of common expenses to the passenger train, the Western Pacific statistical passenger deficit for 1965 was $2,773,000. This means that discontinuance of its last train, if permitted, would have reduced the Western Pacific's statistical deficit to zero but would have increased earnings by only one-fifth of the Western Pacific's statistical passenger deficit. By the same token, if Western Pacific revenues had been $701,000 higher in 1965, it would have gained nothing by discontinuing these trains although its statistical passenger deficit would have been $2,072,000.

the passenger deficit theory was first injected into this case by the Commission's examiners, the Mountain-Pacific railroads offered to prove that they actually received $26 million a year more in passenger revenues than they could save by discontinuance of passenger service under the Commission's own standard for train discontinuances (R. 836).[3] Although the Commission refused to grant a hearing on this new issue, neither the Commission nor any other party has questioned the authenticity of this proof. Thus, the Commission's action in discounting the revenue needs of the Mountain-Pacific railroads because of high passenger deficits "presumably

[3] In interpreting Section 13(a) of the Interstate Commerce Act (49 U.S.C. § 13(a)), involving passenger train discontinuance, the Commission has consistently held that joint costs which are apportioned between freight and passenger traffic cannot be considered in such proceedings, since these costs will continue in effect irrespective of passenger service. For example, in *Chicago and North Western Ry. Co., Discontinuance of Service between Minneapolis, Minn., and Council Bluffs, Ia.*, 307 I.C.C. 463, 471 (1959) the Commission held that alleged savings claimed in general expenses, which included salaries and expenses of general officers, must be disregarded in determining the expenses properly attributable to those trains. Similarly, expenses for maintenance of way and structures were disallowed for the purposes of that decision on the ground that neither of these items of expense can properly be classified as avoidable costs, and, therefore, they have no bearing in determining the actual costs of providing the service to be abandoned.

In *King v. United States*, 344 U.S. 254 (1952), this Court recognized that the discontinuance of passenger trains would not even permit the railroads to save the costs of maintaining highspeed tracks and equipment: "In Florida, morever, the discontinuance of railroad passenger serivce would not permit the discontinuance of high-speed tracks and equipment because of the need for fast freight schedules to transport perishable fruits and vegetables from Florida." Of course, the same need exists with respect to the perishable fruits and vegetables of the West.

not permanent in nature" stands on a record in which an uncontroverted offer of proof has been mare that those deficits cannot be reduced without hurting the overall financial condition of the Mountain-Pacific railroads. This is arbitrary action in the classic sense and it should be set aside as wholly without support in the evidence under Section 10(e) of the Administrative Procedure Act (5 U.S.C. § 706 (2) (E)).

Secondly, the Commission's action in discounting the Mountain-Pacific railroads' overall revenue needs is flatly inconsistent with the established principle that a railroad must be regarded as an integrated utility providing both freight and passenger service. This principle was explicitly recognized in a passenger train discontinuance case by this Court in *Alabama Public Service Commission v. Southern R. Co.*, 341 U.S. 341, 353 (1951):

> "Unlike a department store or a grocery, a railroad cannot of its own free will discontinue a particular service to the public because an item of business has become unprofitable. 'One of the duties of a railroad company doing business as a common carrier is that of providing reasonably adequate facilities for serving the public. This duty arises out of the acceptance and enjoyment of the powers and privileges granted by the State and endures so long as they are retained. It represents a part of what the company undertakes to do in return for them, and its performance cannot be avoided merely because it will be attended by some pecuniary loss.' *Chesapeake & O.R. Co. v. Public Service Com. of West Virginia*, supra (242 U.S. at 607)."

The same principle has been recognized and applied both by the Commission and by this Court in cases involving rates. In a series of cases involving increases

in general freight rates since World War II under § 15 (a)(2) of the Interstate Commerce Act (49 U.S.C. § 15 (a)(2)), the Commission has consistently held that the railroads are entitled to revenues adequate to cover their operating costs and provide a profit on their entire operations, including revenues to offset passenger deficits. In *Ex Parte 168, Increased Freight Rates and Charges,* 276 I.C.C. 9, 36 (1948), the Commission explained the theory of this action as follows:

> "These cases are typical of our more recent holdings upon this question. While we regard it as 'trite to say that each particular service, coach, sleeper, parlor car, and head end should as nearly as may be pay its own way and return a profit' (Eastern Passenger Fares in Coaches, 227 I.C.C. 17, 25), and we have accepted the contention that there may be traffic that should not be burdened with a shortage of passenger service return (Livestock, Western District Rates, 190 I.C.C. 611, 629), yet, if passenger service inevitably and inescapably cannot bear its direct costs and its share of joint or indirect costs, *we have felt compelled in a general rate case to take the passenger deficit into account in adjustment of freight rates and charges*" (emphasis supplied).[4]

The Commission has adopted the same approach in proceedings under Section 13(4) of the Act (49 U.S.C. § 13 (4)), involving the question of whether increases in intrastate rates should be compelled in order to avoid a burden on interstate commerce. And this Court itself

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[4] See also Ex Parte 212, 304 I.C.C. 289, 300-01 (1958), wherein the Commission also held that to the extent passenger service inevitably and unescapably cannot bear its direct costs and a fair share of the joint and direct costs, the deficiency will be made up by other traffic.

expressly upheld this approach in *King v. United States*, 344 U.S. 254, 263-264 (1952):

> "Section 15a(2) of the Interstate Commerce Act and the National Transportation Policy of 1940 reflect this broad concept of the unity of the Nation's transportation system. They direct the Commission to consider, among other things, the need, in the public interest, of adequate and efficient railway transportation service and the need of revenues sufficient to sustain such service. It permeates such general revenue proceedings as Ex Parte Nos. 162 and 166, supra. It leaves no ground for a claim that the Commission may not give weight to passenger revenue deficits in prescribing *interstate* freight rates to meet overall revenues needs."

The principle that the results of passenger service and freight service must be treated together in any case involving the overall revenue needs of a railroad or group of railroads is equally applicable in a divisions case. Indeed, the limitation upon the right of a railroad directly to discontinue service would be meaningless if wholesale discontinuances could be brought about by a divisions case. Common fairness, also, dictates that revenue needs reflected in passenger deficits be recognized in a divisions case where those needs underlie and justify the very rate being divided. Moreover, the language of Section 15(6) plainly applies to the overall revenue needs of the carriers including needs reflected in passenger deficits. The language of that section directs the Commission's attention to:

> ". . . the amount of revenue required to pay their respective operating expenses, taxes and a fair return on their railway property held for and used in the service of transportation."

In *Baltimore & Ohio R. Co. v. United States*, 298 U.S. 349, 360 (1936), the Court held that this provision of the Act must be construed to apply to all property held for and used in the service of transportation, including of course, property held for and used in the service of transporting passengers:

> "The language, 'property held for and used in the service of transportation,' is broad enough to include all carrier property. It requires no discussion to demonstrate that § 15(6) authorizes the Commission to take into account and give weight to revenues from all transportation service, and the operating expenses and taxes chargeable to the same and the amounts available as compensation for the use of all carrier property."

Under this decision, the Commission's action in restricting its decision to revenue needs "as freight carriers" would seem to violate the command of Section 15(6).

But whether or not the Commission has power under Section 15(6) to discount revenue needs because of passenger deficits "presumably not permanent in nature," the Commission's action here cannot stand, for the Commission did not support its action with reasoned findings. Whatever the Commission's power under Section 15(6), it had a duty under Section 8(b) of the Administrative Procedure Act to state a rational explanation of the basis of the action.

In *Secretary of Agriculture v. United States* 347 U.S. 645, 652-653 (1954), this Court made it plain that this duty applied with special force where the Commission

is abandoning an established principle in favor of a wholly new approach:

> ". . . In dealing with technical and complex matters like these, the Commission must necessarily have wide discretion in formulating appropriate solutions. But we do say that while the Commission has adumbrated the reasons that commended these charges to its approval, the Commission has not adequately explained its departure from prior norms and has not sufficiently spelled out the legal basis of its decision. We do not know whether the Commission has disregarded its own findings that the unloading here is a prerequisite to delivery of the goods; or whether, in order to meet an unusual situation, the Commission has modified the normal doctrine that delivery is the responsibility of the carrier, see *New England Coal & Coke Co. v. Norfolk & W. R. Co.*, 33 Inters Com 276; or whether the Commission, for a reason not made explicit, has here deemed irrelevant the prevailing rule of its prior cases that a service necessarily encompassed by the line-haul rate cannot be separately restated without examining the sufficiency of the line-haul rate to cover it. See, e.g., *Terminal Charges at Pacific Coast Ports*, 255 Inters Com 673. In short the Commission has not explained its decision . . ."

This principle is plainly applicable here and requires that the Commission's orders in this case be set aside whatever the Commission's power under Section 15(6).

Finally, the Commission's action in discounting the revenue needs of the Mountain-Pacific railroads is unlawful because it occurred on a record in which a fair hearing was not accorded the parties. All parties to this proceeding, including these appellees, are entitled, as a matter of law, to an opportunity to offer evidence by way of explanation or rebuttal on every factual issue

raised in the proceeding or used by the Commission in its decision. No such opportunity was afforded with respect to the Commission's passenger deficit theory.

There was no notice whatever given that the Commission was considering the passenger deficit theory as a possible ground of decision in this case. None of the parties themselves relied upon any such theory in justification of their positions. On the contrary, each of the parties expressly contended that revenue needs should be based on total operations. Neither the examiners nor any other member of the Commission's staff in any way intimated a contrary view.[5]

The passenger deficit theory was injected into this case by the Commission's examiners to answer a question posed by our brief. We had asked where the Mountain-Pacific railroads would get the funds needed to expand their rail service. The examiners found that such funds were available through "a saving of $67.8 million" a year to be accomplished by discontinuing passenger service (R. 744). As already noted, the Mountain-Pacific railroads offered to prove that this theory was based upon a false premise in that discontinuance of their passenger service would result in a $26 million loss, not a $67.8 million gain, in their overall financial position.

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[5] The only evidence with respect to passenger deficits was presented at a rebuttal hearing in December 1959, by witness John K. Langum (R. 623-630). This evidence was concerned solely with the reproduction of some Commission-published statistics on passenger deficits without explanation of their significance and was offered for the limited purpose of showing that the Chicago and North Western Railway freight and passenger operations were as efficient as those of other railroads. (R. 620-621). *The evidence was not submitted to prove comparative revenue needs.*

In our exceptions, we offered to show just what had been done by the Mountain-Pacific railroads to reduce passenger expenses and remove unprofitable passenger service (R. 863-877). To support this, a study was prepared by these appellees showing in detail passenger train discontinuances in each of the Mountain-Pacific states during the eleven-year period from 1950 to 1960 (R. 863-866).

This analysis showed that since 1950 there was no substantial difference in the decline of railroad passenger service in the various territories (R. 866-869). In our exceptions, we urged the Commission to reopen the proceeding for further hearing so that we might introduce the study to illustrate the Commission's error (R. 863). Our request for further hearing was ignored.

In this situation, the Commission's reliance upon passenger deficit data to discount the actual revenue needs of the Mountain-Pacific railroads constitutes a flagrant denial of the right to a fair hearing—a right which is not only recognized in the Administrative Procedure Act and Section 15(6) itself, but one which is also protected by due process of law.

The seriousness of the failure of the Commission to accord the parties a hearing before it announced the policy of discounting the revenue needs of one group of railroads because of supposedly excessive passenger deficits cannot be overestimated from the standpoint of these appellees. Although the Commission has assured us that this theory does not imply "a need for *wholesale* discontinuance of passenger service" (R. 1075) (empha-

sis supplied), it plainly constitutes an open invitation to the railroads to discontinue a substantial amount of such service. And we think that it is inevitable that some railroads will treat it that way.

Indeed, the recent efforts of the Western Pacific Railroad to discontinue operation of the famous California Zephyr may well be a case in point. As the Commission itself pointed out in its report temporarily preventing discontinuance of this train, the California Zephyr "is one of the finest trains in the United States and enjoys an excellent reputation with the traveling public" *(Western Pacific Discontinuance of Trains Nos. 17 and 18 Between San Francisco, Calif., and Salt Lake City, Utah,* p. 3 (decided February 13, 1967)). Consequently, although this train does produce an out-of-pocket loss to the Western Pacific, the state regulatory commissions of the states which would be affected by the discontinuance have steadfastly opposed the Western Pacific's proposal, urging that the out-of-pocket loss is not too much for the Western Pacific to bear under all the circumstances. So far we have prevailed. But the decision in this case, were it to be upheld, might cast a whole new light on the California Zephyr discontinuance proposal. The Western Pacific could then contend, with some reason, that its whole passenger deficit, not merely its out-of-pocket loss, must be taken into account, since that deficit was being used against it in this divisions case. In such a situation, it might be impossible to prevent any passenger train discontinuance.

We think that the Commission's approach to passenger train discontinuances in this case, which simply

disregards the public interest in maintaining trains and encourages their discontinuance even where no actual out-of-pocket loss is involved, should not have been adopted under any circumstances. In a case where *passenger service was not even an issue,* and where no notice or opportunity to be heard was accorded to any of the parties before the Commission, the Commission's adoption of such an approach becomes incredible. Whatever else the Court does with this case, it should remand it to the Commission to permit a fair hearing on its novel passenger deficit theory—the theory which says that railroads' actual revenue needs will be disregarded unless they reduce their passenger deficits by discontinuing passenger service.

IV. THE DISTRICT COURT'S HOLDING THAT THE COMMISSION SHOULD HAVE CONSIDERED THE IMPACT OF ITS ORDERS UPON THE DENVER AND RIO GRANDE WESTERN WAS CORRECT.

The principal question stressed by the Government in its brief is the soundness of the District Court's holding that in prescribing divisions on the asserted basis of revenue needs, the Commission must determine and consider the needs of individual railroads (Government Brief, pp. 26-45). Indeed, this is the only question properly at issue in the Government's appeal, since it presented no other question in its Jurisdictional Statement (Government Jurisdictional Statement, p. 2). The Government argues that the District Court's holding imposes "a virtually impossible requirement," which would "undermine the congressional purpose in enacting Sec-

tion 15(6)" Government Brief, pp. 27, 19). The Midwestern railroads make substantially the same claim (Midwestern Brief, p. 81).

Although both appellants discuss their position on this issue at some length, it is difficult to determine precisely what their position is. The Government cites a series of cases for the proposition that administrative action can be "conducted on a group or geographical basis" (Government Brief, p. 35). In this part of its brief, it argues that the Commission can take action under Section 15(6) wholly without regard to the situation of individual railroads or the impact of such action upon them (Government Brief, pp. 34-36).

Elsewhere, however, the Government expressly concedes that Section 15(6) permits "individual carriers who consider themselves atypical in certain respects . . . to come forward and request special consideration" (Government Brief, p. 41, note 27). This part of the Government's brief seems to concede that the Commission has a duty under Section 15(6) to determine and consider the individual situation of any railroad that requests it, and here the Government seems to be arguing simply that no individual consideration was necessary in this case because every railroad involved waived its right to such consideration.

Since we cannot tell which of these two positions the Government is actually taking, we shall deal with both of them. However, before turning to a discussion of the legal correctness of the District Court's holding, we think it important to define the nature of this issue as it was

presented to the District Court and to review the manner in which the issue actually arose.

Insofar as the Mountain-Pacific railroads and the Mountain-Pacific states are concerned, the individual carrier problem involves only the Denver and Rio Grande Western. The Commission's order in this case would have had a substantial impact upon each one of the Mountain-Pacific railroads. The only railroad faced with a substantially disproportionate loss, however, was the Rio Grande. The Rio Grande is heavily dependent upon its divisions of transcontinental freight revenues for its continued existence, and it would be particularly vulnerable to the rerouting of traffic which would naturally result from the Commission's orders.

On petition for reconsideration, it was pointed out that the combined effect of the prescribed divisions, together with additional reductions necessary to remain competitive under the new divisions, would virtually ruin that railroad (R. 906-913). Specifically, the Rio Grande offered to prove that the prescribed divisions "would produce a revenue loss of approximately $8\frac{1}{2}$ million [annually] for a railroad whose total net income was $10\frac{1}{2}$ million" (R. 913), so that any substantial reduction in its present level of earnings might put it in bankruptcy.

In its supplemental report, the Commission implicitly recognized that the new divisions would ruin the Rio Grande (R. 1080), but the Commission refused to give any consideration at all to this fact. It reasoned that the Rio Grande had waived its right to object to those

aspects of its orders which imposed these disproportionate losses upon it (R. 1081).

The precise issue before the District Court therefore was whether this holding of a waiver by the Rio Grande was legally sound. And since the District Court found that the Commission's holding of waiver was not legally sound (R. 1732), the precise issue before this Court is whether the District Court erred in reaching this conclusion on the basis of its evaluation of the record.

Appellants' far-ranging discussions of the power of administrative agencies to act on a group basis and of the practical difficulties inherent in a procedure that might require individual findings for more than 300 railroads have little, if any, bearing upon the issue presented by the Rio Grande. The Commission's reports make it plain that it would have considered the situation of the Rio Grande if it had been raised earlier. Since the only ground upon which the Commission's orders can properly be upheld is the ground of waiver upon which the Commission relied (*Securities & Exchange Commission v. Chenery Corp.*, 332 U.S. 194, 196 (1947), these arguments advanced by appellants are really beside the point.

Appellants impute to the District Court a holding that the Commission must separately determine and separately consider the situation of every railroad involved in the case, whether such individual consideration is asked for or not (Government Brief p. 27; see also Midwestern Brief pp. 79, 81). However, the District Court plainly held no such thing, for it expressly relied upon

the typical evidence rule announced by this Court in *New England Divisions*, 261 U.S. 184, 196-197 (1923). That case upheld the power of the Commission to prescribe divisions on a group basis so long as its findings are "based upon evidence which the Commission assumed was typical in character and ample in quantity to justify the finding made in respect to each division of each rate of every carrier." Under this rule, the Commission plainly need not make *separate* findings for any carrier which does not request such findings.

What the District Court did hold, however, was that the Commission should have made such findings with respect to the Rio Grande. Appellants' arguments about 300 carriers only serves to obscure the correctness of that holding. Indeed, in our view, the Government's suggestion that the Commission has power to prescribe divisions without regard to their impact upon individual railroads is unthinkable when it is applied to the problem created for the Rio Grande by the Commission's order.

The Rio Grande is one of the most important railroads in this country. Although it directly serves only three states, it is a vital link in one of the two transcontinental overland routes upon which the economy of the entire West depends. And to two of the states which it directly serves—Utah and Colorado—the Rio Grande is as important as any other railroad which reaches those states.

The Government's suggestion that such a vital part of the nation's transportation system could be destroyed in a divisions case without the Commission even so much

as taking note of that fact is unsound in policy and not supported by so much as a single precedent in either of the appellants' brief. We realize that the Commission's divisions-making power is important. However, that power was conferred upon the Commission in order to permit it to maintain a national transportation system, not to destroy it. Cf. *New England Divisions,* 261 U.S. 184, 191 (1923).

We do not believe that the destruction or serious weakening of the Rio Grande could ever be justified in a divisions proceeding, where no other carrier's financial ability was involved. But whatever *might* be justified on the basis of evidence and findings, we think it plain that no such action can be taken here, where there has been neither evidence nor findings that attempt to justify such a result.

And we think this is so regardless of whether there was or was not a technial waiver of the Rio Grande's right to individual consideration of its needs. We have studied the arguments on this point, and we must say that we agree with the Distrit Court that "there has been no intentional relinquishment of a known right" (R. 1732). But whether there has been such a waiver by the Rio Grande is not, to our mind, the critical issue for a further reason. The Rio Grande cannot waive the right of the people of Utah, Colorado and the rest of the West to adequate rail service. The Commission itself has a responsibility to see that such service is maintained. It plainly failed in that responsibility when it held that it would not consider the situation of the Rio Grande because that situation had not been pressed upon it on a sufficiently early occasion.

CONCLUSION

For the foregoing reasons, the judgment of the District Court setting aside the orders of the Interstate Commerce Commission should be affirmed.

Respectfully submitted,

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